CRE Finance Council®
The Voice of Commercial Real Estate Finance

August 26, 2022

Via electronic mail

Ann E. Misback, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551

regs.comments@federalreserve.gov

RE: Proposed Regulation Implementing the Adjustable Interest Rate (LIBOR) Act Docket No. R-1775, RIN 7100-AG34

Dear Madam Secretary:

The Commercial Real Estate Finance Council ("CREFC") appreciates the opportunity to provide comments to the Board of Governors of the Federal Reserve System (the "Board") on its proposed regulation implementing the Adjustable Interest Rate (LIBOR) Act[1] (the "Act"). We welcome your continued efforts to support a smooth and efficient transition away from the use of LIBOR in financial contracts.

CREFC's members represent U.S. commercial and multifamily real estate investors, lenders, and service providers – a market with $5.3 trillion of commercial ("CRE") and multifamily real estate debt. Commercial banking organizations, insurance companies, Agency mortgage-backed securities ("MBS"), and the commercial mortgage-backed securities ("CMBS") market are the top sources of financings for commercial and multifamily real estate (which includes the important affordable housing sector). As all of these segments are members of CREFC, the trade association is uniquely situated to comment on the potential effects of the Proposal.

CREFC's membership encompasses both balance-sheet and securitized lenders, which are accompanied and complemented by loan servicers, bond trustees, structured finance investors, and a number of third-party service providers. CREFC's comments incorporate the views of these varied parties.

Synthetic LIBOR

While CREFC's members appreciate the benefits that publishing USD LIBOR on a synthetic basis may provide to "tough legacy contracts" governed by the laws of jurisdictions other than the United States or a state within the U.S. ("US law"), the existence of "synthetic LIBOR" introduces significant uncertainty to US law contracts with fallback provisions that are triggered when LIBOR

[1] Regulation Implementing the Adjustable Interest Rate (LIBOR) Act, 87 Fed. Reg. 45,268 (proposed July 28, 2022) (to be codified at 12 C.F.R. pt. 253) (hereinafter the "Proposed Regulation" or the "Proposal").

"cannot be determined" or upon LIBOR being "unavailable", without a corresponding trigger based on LIBOR being declared "not representative".

A commonly occurring example of the uncertainty caused by the publication of synthetic LIBOR arises from contracts governing numerous commercial real estate transactions that define LIBOR as the rate "for deposits in U.S. dollars, for a one-month period, *that appears* on "Thomson Reuters ICE LIBOR# Rates – LIBOR01" (or the successor thereto) as of 11:00 a.m., London time".

With the potential that a rate (i.e., synthetic LIBOR) will continue to *appear* on that particular page for some period of time after June 30, 2023, transaction parties are left in the untenable position of deciding whether to utilize a rate that *appears* on that particular page (even though the FCA has said that the rate is not representative of the underlying market and economic reality LIBOR had been intended to measure)[2] or to ignore what could be viewed as the plain reading of the contract and instead trigger the existing fallback provisions.

These fallback provisions generally provide (1) that the transactions convert to a rate based on the prime rate or another specifically identified rate, or (2) that a determining person select a replacement rate satisfying certain specified characteristics. If synthetic LIBOR is not published or is otherwise disregarded, these contracts would transition to replacement rates based on their terms on the reset date following the LIBOR replacement date – the same time that other LIBOR-based contracts with robust fallback language (e.g., the ARRC-recommended fallback language) would transition.

The Proposal makes it clear that one of the purposes of the Act was "to allow existing contracts that reference LIBOR but provide for the use of a clearly defined and practicable replacement rate, to operate according to their terms."[3] For contracts that convert to a clearly defined and practicable replacement rate (*e.g.*, transactions that convert to a rate based on the prime rate or another specifically identified rate as referenced in clause (1) in the preceding paragraph) that are not covered by the Act, CREFC members believe the Board should not provide guidance on any potential impact synthetic LIBOR may have on these types of contracts.

However, CREFC members believe it is critical for the smooth transition of their legacy LIBOR contracts that the Board provides, for the avoidance of doubt, specific confirmation on the treatment of synthetic LIBOR on contracts covered by the Act. As such, CREFC members suggest that specific confirmation be provided by the Board that clarifies that:

- For contracts that include fallback provisions that permit a party to select a replacement rate when LIBOR is unavailable (or similar language), that party would be considered a "determining person" for purposes of Section 104(c) of the Act and such "determining person" would be entitled to exercise that right on or before the LIBOR replacement date even in the event a nonrepresentative rate called "LIBOR" in the form of synthetic LIBOR continues to be published on and after the LIBOR replacement date; and

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[2] Regulation Implementing the LIBOR Act, 87 Fed. Reg. at 45,272-73.

[3] *Id.* at 45,272.

- Assuming compliance with the required terms of the Act, selection by the determining person of the Board-selected replacement rate would result in the safe harbor provisions of the Act applying to that selection, notwithstanding such selection would occur while LIBOR *appeared* on the particular page specified in the definition of LIBOR.

CREFC believes that an interpretation of the provisions of the Act on contracts covered by the Act if a synthetic LIBOR does exist that is contrary to the above is, at best, implausible. As such, the above confirmation would serve the purposes of the Act by clearly and unambiguously stating that a party whose "authority, right or obligation" to select a replacement for LIBOR that may not be actionable under the contract until LIBOR is "unavailable" (or similar language) may select the Board-selected replacement rate rather than face any residual uncertainty resulting from a nonrepresentative rate called "LIBOR" in the form of synthetic LIBOR being available after the LIBOR replacement date.

Derivative Transactions Linked to Cash Transactions

In the Proposal, the Board established the Board-selected benchmark replacements for various types of *individual* covered contracts. The Board-selected benchmark replacement for derivative transactions under the Proposal is a rate equal to (i) SOFR, compounded in arrears for the appropriate tenor, plus (ii) a stated spread adjustment based on the appropriate tenor (the "Fallback Rate (SOFR)")[4]. With respect to cash transactions that are not consumer loans or covered GSE contracts, which would include CMBS, the Board-selected benchmark replacement is Term SOFR plus the statutory spread adjustment.[5]

Certain CMBS products integrate derivative transactions as part of the structure of fixed-rate cash transactions in order to offer one or more classes of LIBOR-based securities. The payments on these securities are based on receipt of amounts payable under the corresponding derivative (such LIBOR-based security, a "Swap-Linked Security"). As an example, a Swap-Linked Security may be created when the trustee of a fixed-rated conduit securitization trust enters into a swap where the swap counterparty agrees to pay LIBOR based on a notional balance that varies during the life of the transaction based on the principal balance of the related class of securities, in exchange for the payment by the trustee of certain fixed-rate payments.

The derivative transaction is an integral part of the structure and terms of the Swap-Linked Security. In circumstances where the derivative transaction and the Swap-Linked Security are both covered contracts under the Act, CREFC's members are concerned that implementing the Proposed Regulation as currently drafted could result in a derivative transaction converting to Fallback Rate (SOFR) on the LIBOR replacement date and the Swap-Linked Security converting to Term SOFR plus the statutory spread adjustment, thereby circumventing the expectations of the transaction parties and causing unexpected payment mismatches between the securitization trust and the swap. These payment mismatches would have unexpected consequences not only in terms of the payments to the holders of the Swap-Linked Security, but also to other classes of unrelated securities issued as part of the related securitization.

[4] *Id.* at 45,274.

[5] *Id.*

CREFC's members propose the Board modify the Proposed Regulation to provide that for any covered contract that is a derivative transaction executed in connection with a cash transaction where the terms of such cash transaction were structured to reflect payments under the related derivative transaction, the Board-selected benchmark replacement for such derivative transaction should be Term SOFR plus the statutory spread adjustment to match the Board-selected benchmark replacement of the related cash transaction. This modification can be accomplished by incorporating the following new definitions as part of the Proposed Regulation and revising §253.4(a) as indicated below.

New Definitions:

"Swap-Linked Security" means a LIBOR contract that is an "asset-backed security"[6] issued in connection with a Linked Derivative Transaction.

"Linked Derivative Transaction" means a LIBOR contract that is a derivative transaction, (a) that is executed by the trustee or obligor of a Swap-Linked Security in connection with the issuance thereof, and (b) payments on which are calculated by reference to the outstanding principal balance of the Swap-Linked Security.

Proposed Modification to §253.4(a)

§ 253.4 Board-selected Benchmark Replacements.

(a) *Derivative transactions.* On the LIBOR replacement date, a covered contract that is a derivative transaction, other than a Linked Derivative Transaction, shall use the benchmark replacement identified as the "Fallback Rate (SOFR)" in the ISDA protocol. For clarity, the reference to "spread relating to U.S. dollar LIBOR" in the definition of "Fallback Rate (SOFR)" in the ISDA protocol is equal to the applicable tenor spread adjustment identified in paragraph (c) of this section. On the LIBOR replacement date, a covered contract that is a Linked Derivative Transaction shall use the benchmark replacement that applies to the related Swap-Linked Security.

Notice Provisions

The Board requested feedback on whether any additional clarifications should be considered regarding selection of benchmark replacements by determining persons, specifically whether the Board should consider requiring a determining person to provide notice to one or more parties concerning the selection and, if so, what specific notification requirements would be appropriate and why.[7]

CREFC's members do not believe any clarification or other guidance is necessary or appropriate in this context. The LIBOR transition process has been ongoing over the past five plus years, and during that time, market participants have invested an enormous amount of time and effort analyzing their existing contracts and determining the requirements under those contracts and the manner in which the transition away from LIBOR should occur, including appropriate notices to

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[6] Securities Exchange Act of 1934, § 3(a)(79), 15 U.S.C. § 78c(a)(79).

[7] 87 Fed. Reg. at 45,277.

transaction participants that may be required under the terms of those contracts, that are necessary to comply with applicable regulations or that are otherwise appropriate under the circumstances. Any additional guidance at this point would not serve the purposes of the Act and may introduce uncertainty around already determined and appropriate courses of action.

Conforming Changes

The Board requested feedback on whether any benchmark replacement conforming changes should be considered. CREFC's members believe that existing guidance on benchmark replacement conforming changes is sufficient and do not believe any specifically identified benchmark replacement conforming changes will be necessary or helpful in the transition away from LIBOR.

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CREFC appreciates the opportunity to comment on the Board's Proposed Regulations.

Sincerely,

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